BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP – Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC POWER COOPERATIVE, INC. FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON AND TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN.

DOCKET NO. E-01773A-12-0305

DECISION NO. 74173

OPINION AND ORDER

DATES OF HEARING:	July 22 (pre-hearing conference), July 29, and August 1, 2013
PLACES OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Teena Jibilian
APPEARANCES:	Mr. Michael M. Grant and Ms. Jennifer A. Cranston, GALLAGHER & KENNEDY, on behalf of Applicant;
	Messrs. Michael W. Patten and Jason D. Gellman, ROSHKA DEWULF & PATTEN, PLC, on behalf of Trico Electric Cooperative, Inc.;
	Mr. Jeffrey W. Crockett, BROWNSTEIN HYATT FARBER SCHRECK, on behalf of Sulphur Springs Valley Electric Cooperative, Inc.;
	Messrs. William P. Sullivan and Michael A. Curtis, CURTIS, GOODWIN, SULLIVAN, UDALL & SCHWAB, PLC, on behalf of Mohave Electric Cooperative, Incorporated.; and
	Messrs. Scott Hesla and Charles Hains, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

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Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

Procedural History

1. On July 5, 2012, Arizona Electric Power Cooperative, Inc. ("AEPCO" or "Cooperative") filed with the Arizona Corporation Commission ("Commission") an application for a rate decrease. The application also requested continuation of its Purchased Power and Fuel Adjustor Clause ("PPFAC"), with modifications, and approval of revised depreciation rates. The Direct Testimony of AEPCO's witnesses Peter Scott and Gary E. Pierson were filed with the application.

2. On August 8, 2012, AEPCO filed additional and revised schedules.

3. On August 10, 2012, the Commission's Utilities Division ("Staff") issued a Letter of Sufficiency, indicating that AEPCO's application met the sufficiency requirements outlined in A.A.C. R14-2-103, and classifying AEPCO as a Class A utility.

4. On August 22, 2012, Trico Electric Cooperative, Inc. ("Trico") filed a Motion to Intervene.

5. On August 24, 2012, Staff filed a Proposed Schedule for Filing Dates.

6. On August 28, 2012, AEPCO filed a Response to Staff's Proposed Schedule.

7. On September 4, 2012, Staff filed a Reply to AEPCO's Response to Staff's Proposed Schedule.

8. On September 11, 2012, a Rate Case Procedural Order was issued setting a hearing and associated procedural schedule for the processing of the application, and granting intervention to Trico.

9. On September 21, 2012, AEPCO filed an Affidavit of Mailing indicating that the public notice required by the Rate Case Procedural Order was mailed to each of AEPCO's Class A members on September 19, 2012.

10. On December 14, 2012, AEPCO filed Affidavits of Publication indicating that the public notice required by the Rate Case Procedural Order was published in the *Arizona Daily Star*, the *Kingman Daily Miner*, and the *Sierra Vista Herald* and *Bisbee Daily Review* on November 2 and 16, 2012; and in the *Eastern Arizona Courier* on November 3 and 17, 2012.

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11. On December 20, 2012, Sulphur Springs Valley Electric Cooperative, Inc. ("SSVEC") filed an Application for Leave to Intervene.

12. On February 7, 2013, a Procedural Order was issued granting intervention to SSVEC.

13. On February 26, 2013, Staff filed a Request for Revision of Schedule for Filing Testimony.

14. On March 5, 2013, a Procedural Order was issued revising certain filing deadlines in this proceeding, as requested by Staff.

15. On April 29, 2013, Staff filed a Motion for Extension of Time to File Direct Testimony.

16. On May 1, 2013, Staff filed the Direct Testimony of Staff witnesses Randall Vickroy, John Antonuk, Dennis M. Kalbarczyk and Richard Mazzini.

17. On May 20, 2013, Staff filed the Direct Rate Design Testimony of Staff witness Dennis M. Kalbarczyk.

18. On May 23, 2013, Mohave Electric Cooperative, Incorporated ("Mohave") filed a Motion to Intervene.

19. On May 24, 2013, AEPCO filed a Motion to Extend Rebuttal Testimony Due Date.

20. On May 29, 2013, a Procedural Order was issued granting intervention to Mohave and extending the deadline for the filing of Rebuttal Testimony.

21. On June 13, 2013, AEPCO filed the Rebuttal Testimony of its witnesses Gary E. Pierson and Richard P. Kurtz; Trico filed the Rebuttal Testimony of its witness Vincent Nitido; and Mohave filed the Rebuttal Testimony of its witnesses J. Tyler Carlson and Carl N. Stover.

22. On July 3, 2013, Staff filed the Surrebuttal Testimony of its witnesses Randall Vickroy, Donald T. Spangenberg, Jr., Dennis M. Kalbarczyk, and Richard Mazzini.

23. On July 17, 2013, AEPCO filed the Rejoinder Testimony of its witnesses Gary E. Pierson and Richard P. Kurtz, and Mohave filed the Rejoinder Testimony of its witness Carl N. Stover.

24. On July 22, 2013, the pre-hearing conference was held in this matter as scheduled. AEPCO, Trico, SSVEC, Mohave, and Staff appeared through counsel.

25. Between July 23, 2013 and August 27, 2013, approximately 55 public comments were docketed in favor of AEPCO's proposed rate decrease.

26. On July 23, 2013, AEPCO filed a revised page 1 of its witness Peter Scott's Direct Testimony, which reflects his current position as Chief Financial Officer of Sierra Southwest Cooperative Services.

27. On July 24, 2013, AEPCO filed Exhibit GEP-11 as a supplemental exhibit to the Rejoinder Testimony of Gary E. Pierson.

28. On July 25, 2013, AEPCO filed testimony summaries of its witnesses.

29. On July 26, 2013, Trico and Mohave filed the testimony summaries of their witnesses.

30. On July 26, 2013, Staff filed testimony summaries of its witnesses and Notice that Mr. Vickroy would be available to testify at hearing.

31. On August 29, 2013, the hearing convened as scheduled. Prior to the taking of evidence, members of the public appeared and provided public comment in favor of AEPCO's requested rate decrease. AEPCO, Trico, SSVEC, Mohave, and Staff appeared through counsel, presented evidence for the record through witnesses, and had an opportunity to cross-examine the witnesses of other parties.

32. On August 30, 2013, initial closing briefs were filed by AEPCO, Trico, Mohave, and Staff.

33. On September 4, 2013, Mohave filed a Notice of Errata and a corrected initial closing brief.

34. On September 12, 2013, reply closing briefs were filed by AEPCO, Trico, Mohave, and Staff.

Description of AEPCO

35. AEPCO is a non-profit customer-owned cooperative serving the wholesale power needs of its member distribution cooperatives, who use power supplied by AEPCO to meet the electricity needs of their retail members. AEPCO's three Class A partial-requirements members are Trico, Mohave, and SSVEC ("PRMs"), and AEPCO's three all-requirements members are Anza Electric Cooperative, Inc. ("Anza"), Duncan Valley Electric Cooperative, Inc., and Graham County

Electric Cooperative Inc. ("ARMs" or "CARMS"). With the exception of Anza, which is located in south-central California, AEPCO's member distribution cooperatives are located in rural areas of Arizona. AEPCO also has a Class D member, Valley Electric Association, Inc., which has a service contract with AEPCO for scheduling and trading services, but takes no power from AEPCO.

36. AEPCO was founded in 1961. Through a major restructuring in 2001, AEPCO was reorganized into three entities: AEPCO, which serves the power supply needs of the member cooperatives; Southwest Transmission Cooperative ("SWTC"), the transmission entity that serves the transmission needs of the member cooperatives; and Sierra Southwest Cooperative Services, which provides services and personnel for both AEPCO and SWTC.

37. AEPCO is governed by its 13-member Board of Directors, one selected by each of AEPCO's member cooperatives.

38. AEPCO supplies power to its members produced at its Apache Generating Station ("Apache" or "Apache Station") and from power purchase arrangements, which include short-term and long-term purchase agreements with other utilities.

39. Apache is AEPCO's sole physical generating asset. It consists of Steam Units 1, 2 and 3, and Gas Turbines 1, 2, 3, and 4. Steam Unit 1 is a gas-fired unit positioned to operate in a combined cycle mode with Gas Turbine 1 for a total output of 85 MW. Steam Units 2 and 3 are two coal-fired units with capacity of 175 MW each. Gas Turbines 2, 3, and 4 are peaking units with a combined capacity of 129 MW. Steam Units 2 and 3 currently produce virtually all of Apache's energy output.

40. AEPCO's current rates were approved in Decision No. 72055 (January 6, 2011), as amended by Decision No. 72735 (January 6, 2012).

41. Decision No. 72055 ordered AEPCO to conduct a study of the future role of Apache Station to include the potential rate impacts associated with looming Environmental Protection Agency ("EPA") rulemakings regarding mercury emissions, coal ash, and any other known or pending EPA regulatory actions that could impact the Apache Station, AEPCO, and its customers, and to provide recommendations to the Commission regarding potential methods for mitigating the exposure to those rate impacts, for the Commission's review and consideration.

Overview of Application

42. In the test year ended December 31, 2011, AEPCO had adjusted net operating income of $14,964,121 on adjusted revenues of $154,924,871, resulting in a debt service coverage ratio ("DSC") of 1.56, and a 5.73 percent rate of return on original cost rate base ("OCRB") of $261,075,032.[1]

43. The application requested an overall 2.92 percent decrease in AEPCO's revenue requirement.

44. AEPCO subsequently modified its request to reflect a revenue decrease of $4,287,465, or approximately a 2.77 percent decrease over its current revenues,[2] and now proposes the rates appearing in Exhibit A, attached hereto and incorporated herein.

45. AEPCO requests less of a decrease for the ARMs than for the PRMs, and a slight increase for Trico.[3] AEPCO's witness states that this is the result of excluding the peaking capacity and energy costs of Mohave and SSVEC from AEPCO's revenue requirement, because Mohave and SSVEC elected to purchase requirements in excess of base resources from parties other than AEPCO.[4]

46. AEPCO's requested revenue decrease results in a DSC of 1.32.[5]

47. The application requests continuation of the PPFAC with some modifications and authorization of an efficacy provision.

48. On a cash basis, the requested operating income would generate approximately $5.0 million of working capital on an annual basis.[6] AEPCO's witness states that AEPCO has determined it should build gradually to $20 million in working capital to support its operational requirements, and that the operating income (margins) it requests will assist in the process of achieving that working capital level over the next several years.[7]

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[1] Rebuttal Testimony of AEPCO witness Gary E. Pierson, Hearing Exhibit ("Exh.") AEPCO-5 at Exhibit GEP-4.
[2] Rejoinder Testimony of AEPCO witness Gary E. Pierson, Exh. AEPCO-6 at Exhibit GEP-9.
[3] *Id.* at Exhibit GEP-10.
[4] Direct Testimony of AEPCO witness Peter Scott, Exh. AEPCO-1 at 5.
[5] Exh. AEPCO-6 at Exhibit GEP-9.
[6] Exh. AEPCO-1 at 6-7.
[7] *Id.*

49. The application includes an assessment of the gas and coal fired units at Apache Station conducted by Black & Veatch Corporation. Based on that study, AEPCO requests approval of: revised depreciation rates for production units and additions prior to December 31, 2013; depreciation rates for additions after December 31, 2013; and net decommissioning cost amortization. The depreciation rates for which AEPCO requests approval appear in Exhibit B, attached hereto and incorporated herein.

Apache Station Study Process

50. After the application was filed, AEPCO informed Staff of pending regulatory rule changes at the EPA that would impact the costs of operating Apache.[8] At that time, AEPCO provided Staff with a preliminary estimate of $190 million in compliance costs for the EPA Regional Haze Federal Improvement Plan ("FIP"), leading Staff's witness to state the following:

> The EPA's recent ruling regarding environmental compliance requirements for AEPCO's two coal-fired units at the Apache Station have greatly increased the risk of new-build exposure relative to the existing asset base. This factor is crucial because G&T cooperatives largely finance new capital investment with debt and rely upon rate increases to service the debt. AEPCO faces the prospect of at least $190 million of capital expenditures to meet EPA requirements over the next 3 to 5 years.
> Direct Testimony of Staff witness Randall Vickroy (Consultant), Exh. S-4 at 14.

51. Staff's Direct Testimony also raised issues concerning decreased competitiveness of Apache due to the availability of less expensive combined cycle gas generation. Staff's engineering witness made the following recommendations in regard to Apache:

- A comprehensive study of the future of Apache should be completed within the next six months. The study should feature:
  - Comprehensive operating scenarios based on the economics of the station.
  - Assessment of remaining life based on economics, physical condition and planned operating mode.
  - A starting assumption that the EPA issues will not affect the station.
    - The results can then be used to assist in developing EPA strategies for dealing with the EPA issues.
    - A second phase of the study, when EPA impacts are clearer, can be conducted if appropriate.
  - Consideration of independent third party oversight to assure that assumptions, methods, and conclusions are reliable.
  - Rate analyses to determine what, if any, stranded costs will be borne by the member cooperatives and their customers.

Direct Testimony of Staff witness Richard Mazzini (Consultant), Exh. S-6 at 3.

[8] Staff Initial Closing Brief ("Br.") at 2.

52. Subsequently, in Rebuttal Testimony, AEPCO's witness provided a new, lower estimate of approximately $30 million for EPA compliance. AEPCO now believes it has made substantial progress with the EPA toward a more reasonable and cost-effective solution to deal with the impact of the EPA Regional Haze requirements.[9] On May 29, 2013, AEPCO filed a supplement to its Petition for Administrative Reconsideration, setting forth AEPCO's Best Available Retrofit Technology ("BART") alternative proposal for Apache Steam Units 2 and 3 for regional haze requirements compliance.[10] AEPCO's BART alternative proposal consists of switching Steam Turbine Unit 2 to natural gas, and installing a Selected Non-Catalytic Reduction ("SNCR") retrofit for Steam Turbine Unit 3, which would require approximately $30 million in capital requirements, much less than the estimated $190 million cost of the FIP.[11] On June 6, 2013, the EPA granted partial reconsideration of AEPCO's FIP in response to AEPCO's proposed BART alternative, and AEPCO believes the EPA will give serious consideration to its alternative proposal.[12]

53. At the hearing, in response to Staff's recommendations regarding the need for a comprehensive study of the future of Apache, AEPCO presented the following language and clarification regarding the study, for which it requests approval. The language was reviewed and agreed to by Staff:[13]

> APACHE STATION STUDY
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> The Strategic Resource Planning Group ("SRPG") Apache Station Study (which has already begun) involves a detailed comparison of the continued operations of Steam Turbines 2 and 3 under AEPCO's BART proposal with a mix of all resource supply options/modifications including, but not limited to: capacity and energy purchases, purchase of existing supply resources; different operating configurations of the two steam turbine units; construction of new natural gas-fired resources; and replacement purchased power agreements ("PPA") with associated transmission upgrades. The study will examine the impacts of these and other scenarios on operating costs, capital requirements, stranded investment and unit retirement costs under a range of forecasts for key operating parameters (for example, fuel costs). We will also conduct a Request for Proposal ("RFP") or similar process to verify market assumptions and long-term PPA market costs. That process will make clear to market participants that our interest in potential purchases is real, and not limited merely to amassing information for study purposes. The foregoing information will then be used by AEPCO in determining what resource options to pursue (including but not limited to those identified as part of the RFP process) and in preparing financial forecasts and rate projections.

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[9] Rebuttal Testimony of AEPCO witness Gary E. Pierson, Exh. AEPCO-5 at 2.
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *See* Hearing Transcript ("Tr.") at 54-55; Staff Br. at 5.

> The results of the SRPG study and supporting analyses will be submitted to the Commission (as will a non-confidential executive summary that can be made available to the public) on or before June 30, 2014. The results of the study will consider the relevant factors affecting the continuing viability of Apache Station including, without limitation, pending and future EPA requirements. The study and resulting dialogue with stakeholders, including the Commission, will become the lynchpin of AEPCO's resource planning and capital budgeting process. We will seek to determine what options best suit the needs of our Members over the long term, without prejudging the prudence of continuing or ceasing investments in Apache Station in accordance with Section R14-2-103(A)(3)(1) of the Arizona Administrative Code. AEPCO will, during the pendency of the study and within a reasonable time for review of the results of the study, limit investments at Apache Station to those clearly required for legal, regulatory, and safety reasons and for preserving operational capability and availability. But our intent in conducting the study remains the same – we will not make other major investments (e.g. major environmental equipment upgrades) until after the study is completed and, then, only in the event and to the extent that such investments are supported by the study.
> Exh. AEPCO-7.

54. AEPCO's witness stated that the purpose of the Apache Station Study is: (1) to confirm that spending $30 million and increased operating costs related to the BART alternative proposal for environmental upgrades at Apache as a result of EPA regulations is the best possible course of action for AEPCO;[14] and (2) to explore all other alternatives to the BART alternative proposal, including the EPA FIP, or replacing the coal units with some other resource, given current market pricing and fuel cost projections.[15]

55. No party objected to AEPCO's proposed Apache Station Study Process.

Rate Base

56. The parties agree that AEPCO's OCRB is $261,075,032.

Test Year Revenues

57. AEPCO proposed, and no party disputed, adjusted test year revenues of $154,924,871.

Expenses

58. AEPCO proposed, and no party disputed, adjusted test year expenses of $148,660,579.

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[14] Tr. at 46.
[15] Tr. at 46-47.

Revenue Requirement

59. AEPCO requests a revenue decrease of $4,287,465 or approximately a 2.77 percent decrease over test year revenues of $154,924,871.[16] The requested revenue decrease would provide a revenue level of $150,637,406 and net operating income (margin) of $1,957,221, and would result in a DSC of 1.32, the same DSC approved in Decision No. 72055.[17] In conjunction with the revenue decrease, AEPCO requests approval of an Environmental Compliance Adjustment Rider ("ECAR"), discussed further below, to recover costs of future environmental compliance obligations. Mohave and Trico support approval of AEPCO's requested revenues and rates, along with approval of the ECAR.

60. AEPCO's adjusted revenue reduction request and rate design would result in a rate decrease to the ARMs of 1.61 percent; and would impact rates of the PRMs as follows: Mohave, 5.60 percent decrease; SSVEC, 3.53 percent decrease, and Trico, 1.16 percent increase.[18]

61. Staff is opposed to AEPCO's request for authorization to decrease its revenues, recommending instead that no change be made to revenues at this time. Staff's recommendation would result in a DSC of 1.55, providing net operating income of $6,244,686.[19]

62. Staff's revenue and rate design proposal would result in a rate increase to the ARMs of 1.20 percent; and would impact rates of the PRMs as follows: Mohave, 2.99 percent decrease; SSVEC, 1.11 percent decrease, and Trico, 4.51 percent increase.[20]

63. Staff argues that a higher DSC than that approved in the previous rate case is warranted in this case, because AEPCO faces significant challenges and risks that were not present in its last rate case, including EPA regulations and decreased competitiveness of Apache due to the availability of less expensive combined cycle gas generation.[21] Staff asserts that its recommended 1.55 DSC would allow AEPCO to pay for the capital costs associated with the BART alternative

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[16] Rejoinder Testimony of AEPCO witness Gary E. Pierson, Exh. AEPCO-6 at Exhibit GEP-9. Class A Member Electric Revenues were $154,924,871. (*See* Exh. AEPCO-5 at Exhibit GEP-4, p. 3 of 4, lines 1 and 5.)
[17] Exh. AEPCO-6 at Exhibit GEP-9, Col. E. Class A Member Electric Revenues of $150,637,406. (*See* Exh. AEPCO-5 at Exhibit GEP-4, p. 3 of 4, lines 1 and 5.)
[18] Exh. AEPCO-6 at Exhibit GEP-10, Col. 6.
[19] Exh. AEPCO-6 at Exhibit GEP-9, Col. D.
[20] Exh. AEPCO-6 at Exhibit GEP-10, Col. 5.
[21] Staff Br. at 3; Staff Reply Closing Brief ("Reply Br.") at 2-4.

proposal, assuming the EPA accepts it, without the need for an additional rate increase or the need for an ECAR.[22]

64. Staff states that when the Apache Station Study is completed in June 2014, AEPCO must decide the course of action to take regarding Apache, just seven months after AEPCO requests that rates be decreased.[23] Staff asserts that AEPCO will certainly need to expend a substantial amount of money in the near future as a result of EPA regulations affecting Apache Station,[24] and that a DSC ratio of 1.32 is insufficient to meet the lower end of the potential capital financing obligations for EPA compliance, even assuming the EPA accepts AEPCO's $30 million BART alternative proposal.[25] Staff argues that customers deserve rate stability and predictability, and that because AEPCO will need to increase its rates in order to fund improvements estimated to cost between $30 million and $190 million to comply with EPA requirements, it would be inappropriate to briefly reduce rates now only to raise them to much higher levels later.[26] Staff points out that increased rates through the ECAR do not alleviate the concern of rate shock to customers.[27]

65. AEPCO, Mohave and Trico strongly disagree with Staff's recommendation to deny the requested revenue decrease, and urge that approval of the decrease, coupled with the ECAR, is the better option. AEPCO, Mohave and Trico take issue with Staff's assertion that a rate increase is inevitable, based on either environmental compliance costs or the cost competitiveness of Apache, and argue that Staff's recommendation is based on speculation, not specifics.[28] They point out that Staff's recommended revenue requirement would result in the collection of an additional $17 million from customers over its requested revenues by 2017,[29] and that this represents more than 60 percent of the anticipated approximately $30 million BART alternative proposal expenditure.[30] Mohave and AEPCO argue that without the rate decrease, these dollars could never be returned to AEPCO's

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[22] Staff Br. at 6; Staff Reply Br. at 3, 5.
[23] Staff Br. at 5.
[24] Staff Br. at 3, 5; Staff Reply Br. at 1-2.
[25] Staff Br. at 4; Staff Reply Br. at 3.
[26] Staff Br. at 2-3, 5; Staff Reply Br. at 2, 4-5.
[27] Staff Reply Br. at 3-4.
[28] AEPCO Br. at 11-13; AEPCO Reply Br. at 2-4; Trico Br. at 6-8; Trico Reply Br. at 1; Mohave Br. at 8-9; Mohave Reply Br. at 2-4.
[29] AEPCO Br. at 3; Trico Reply Br. at 1; Mohave Reply Br. at 4.
[30] AEPCO Br. at 3.

members,[31] and Trico joins AEPCO in arguing that requiring current customers of distribution cooperatives to essentially fund a long-term capital improvement up front in this manner is unnecessary and unfair, and disregards the impact on the distribution cooperatives' customers.[32] Mohave points out that public officials and members of the public who provided comment to the docket vigorously support the requested decrease, even if it means rates will have to increase in the future.[33] Mohave and Trico assert that Staff's recommended rates do nothing to ensure that AEPCO will meet its environmental mitigation responsibilities, or to make Apache more competitive in the energy market.[34] AEPCO, Trico and Mohave argue that an increase to AEPCO's revenue requirement should occur only when the costs to comply with EPA regulations are known and measurable; that the concept of rate stability should not be used as an excuse to overcharge ratepayers now, based on non-quantifiable future needs; and that the Commission should reduce rates now, and approve the ECAR, which will allow AEPCO to promptly and fairly, subject to Commission oversight and approval, address environmental compliance costs, once they are known and the solution is being implemented.[35]

66. AEPCO, Trico and Mohave also take issue specifically with Staff's higher DSC recommendation. They argue that Staff's recommendation appears to conclude that the appropriate DSC is whatever is produced from the current rates, and arbitrarily deviates from the standards and rules that the Commission has employed in the past to determine whether rates are just and reasonable.[36] Mohave argues that Staff's witness misapplied Moody's five risk criteria.[37] AEPCO, Trico and Mohave contend that Staff's recommendation overstates AEPCO's risk, because it does not take into account the fact that AEPCO's Class A members provide full recovery of AEPCO's fixed costs through their contracts;[38] the fact that AEPCO's PPFAC allows it to timely recover purchase power costs;[39] and the fact that AEPCO has actively worked with its members to achieve cost

[31] Mohave Reply Br. at 4; AEPCO Reply Br. at 7.
[32] AEPCO Br. at 3, 13; Trico Br. at 1, 2.
[33] Mohave Br. at 1-2.
[34] Mohave Reply Br. at 5; Trico Reply Br. at 2.
[35] Trico Reply Br. at 3; AEPCO Reply Br. at 4; Mohave Br. at 12-13.
[36] Mohave Br. at 8-9; Trico Reply Br. at 2.
[37] Mohave Br. at 3-8.
[38] AEPCO Br. at 4; Trico Reply Br. at 1.
[39] AEPCO Br. at 5; Trico Reply Br. at 2.

savings.[40] Mohave contends that AEPCO's risk is further reduced by the proposed ECAR, which will allow AEPCO to adjust rates to collect known and definite costs associated with implementing EPA mandates.[41] Trico argues that the record shows that AEPCO's current financials would support an investment-grade rating; the equity ratios for both AEPCO and its member cooperatives are improving; the Commission's regulatory environment has improved with the enactment of streamlined ratemaking rules for cooperatives; AEPCO is not responsible to obtain additional resources for its PRMs; and AEPCO's smaller size and rural service territory has not drastically changed since the last rate case, but it enjoys a stable yet diversified customer base.[42]

Rate Design

67. AEPCO prepared a fully allocated cost of service study ("COSS")[43] as a basis for its proposed rate design.[44]

68. Staff reviewed and analyzed the COSS and rate design, and confirmed that the methods and approach used to develop rate design were the same as that approved in AEPCO's prior rate case.[45]

69. There is no disagreement by any party with the proposed rate design.[46]

PPFAC

70. AEPCO requests authorization to continue its existing PPFAC. AEPCO requests that the following be included in the authorization, as set forth in the following Findings of Fact: an efficacy provision as included in prior rate cases; two modifications; an initial semi-annual PPFAC filing; and a temporary tariff rider.[47]

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[40] Mohave Br. at 10; Trico Reply Br. at 2.
[41] Mohave Br. at 10.
[42] Trico Br. at 2, 7-8.
[43] Direct Testimony of AEPCO witness Gary E. Pierson, Exh. AEPCO-4 at 16-23 and Schedules G-1 through G-8.
[44] Exh. AEPCO-4 at 23-26 and Schedules H-1 through H-3.
[45] Direct Testimony of Staff witness Dennis M. Kalbarczyk, Exh. S-2 at 4-6.
[46] Rebuttal Testimony of AEPCO witness Gary E. Pierson, Exh. AEPCO-5 at 15.
[47] AEPCO Br. at 1-2.

71. Efficacy Provision. AEPCO requests that it be allowed to request a Commission efficacy review of the PPFAC, and suggests language such as that appearing in Decision No. 72055 which allows AEPCO to file a request that the Commission review the efficacy of the PPFAC with submission of any semi-annual report required by the PPFAC tariff and the Decision.

72. First Modification. AEPCO requests that the PPFAC tariff be modified to remove AEPCO's fixed fuel costs from the calculation of the PPFAC Base Resources and Other Resources Bases, and to instead track and recover those fixed costs through the establishment of a fixed fuel costs base and a separate adjustor rate based on a monthly charge.

73. Second Modification. AEPCO requests that the PPFAC tariff be modified to remove the PPFAC bank balances from the fuel adjustor rates and recover those amounts, along with the fixed fuel costs bank balance, through a continuing six-month amortization tariff rider.

74. Initial Semi-Annual PPFAC Filing. AEPCO requests authorization of an initial semi-annual PPFAC rider that is based on data covering the 12 months ended December 31, 2013, to be made on March 1, 2014, to become effective on April 1, 2014. Thereafter, fuel adjustor filings would become effective April 1 and October 1, based upon data covering historic performance during the prior 12 months ended December 31 and June 30, respectively.

75. Temporary Tariff Rider. AEPCO requests authorization of a temporary tariff rider to close out the current PPFAC by refunding or collecting the outstanding Class A members' bank balances as of November 1, 2013, based on a 12-month amortization.

76. No party objected to AEPCO's requests concerning the PPFAC.

ECAR

77. In response to Staff's expressed concerns regarding potential costs associated with the EPA Regional Haze regulations, AEPCO proposed the concept of a surcharge mechanism to provide recovery of potential costs associated with future environmental compliance obligations in the form of an Environmental Compliance Adjustment Rider, or "ECAR."[48] Mohave and Trico are supportive of implementation of an ECAR in conjunction with a revenue decrease.

[48] Rebuttal Testimony of AEPCO witness Gary E. Pierson, Exh. AEPCO-5 at 7-8 and Exhibits GEP-7 and 8.

78. Staff does not oppose the concept of an ECAR as a cost recovery mechanism, so long as it is used for projects that are the best long-term solution for AEPCO and its members.[49] Staff states that a number of details remain to be addressed, however. In particular, Staff is concerned that the draft ECAR provided by AEPCO lacks minimum or maximum dollar amounts and specificity regarding environmental compliance obligations; does not address whether the surcharge will base revenue requirements upon short- or long-term financing, or simply upon ongoing operating cash requirements; does not include a formalized process and list of regulatory accounts to be used for recording funds received and classification of qualified environmental assets; and does not include a provision requiring that the ECAR remain subject to Commission audit on an annual or bi-annual basis.[50] According to Staff, collaborative work sessions between AEPCO and Staff may be appropriate to address these technical concerns, prior to the filing of a revised plan of administration in this docket.[51]

79. AEPCO agrees that if the Commission approves its requested revenue decrease, this docket should be held open so that the parties can work together to refine the process for and details of the ECAR, and so that AEPCO and Staff can bring a joint recommendation to the Commission for approval of an ECAR tariff and plan of administration.[52] AEPCO proposes to file the ECAR mechanism and tariff rider set at zero on or before April 30, 2014, for Commission approval,[53] and to continue discussions with Staff regarding ECAR details while the Apache Station Study is being conducted.[54] Next, based on the results of the Apache Station Study, which will be filed by June 30, 2014, AEPCO states that it will work with its members to prepare an environmental compliance strategy ("ECS") to address the EPA regional haze requirements.[55] AEPCO plans to then file a request to set the ECAR surcharge based on the detailed costs identified in the ECS.[56] AEPCO

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[49] Tr. at 228.
[50] Surrebuttal Testimony of Staff witness Dennis M. Kalbarczyk, Exh. S-3 at 7. Staff also raised additional preliminary matters to be addressed prior to implementation of an ECAR, which appear to be addressed by the proposed Apache Station Study Process.
[51] Surrebuttal Testimony of Staff witness Dennis M. Kalbarczyk, Exh. S-3 at 6.
[52] Rejoinder Testimony of AEPCO witness Gary E. Pierson, Exh. AEPCO-6 at 7, 9; AEPCO Br. at 6-7.
[53] Tr. at 83-84.
[54] Exh. AEPCO-6 at 8.
[55] Exh. AEPCO-5 at 8.
[56] Tr. at 83-84.

believes this procedure will provide sufficient time for its BART alternative proposal, if approved, to be operational by December 2017.[57]

Expiring Purchase Power Contracts

80. AEPCO notes that rates for Trico and the ARMs include costs and charges for two purchase power agreements that expire in October 2014, and that AEPCO is committed to address this issue with the Commission in 2014 to remove the costs and charges related to the contracts from its rates when the contracts expire.[58] Trico and AEPCO propose that this Decision require AEPCO to file an application in this docket no later than August 1, 2014, requesting to remove from its rates all costs and charges related to two purchase power contracts that expire on October 31, 2014, and that this docket be held open for that purpose.[59]

Depreciation Rates

81. AEPCO requests approval of revised depreciation rates for production units and additions prior to December 31, 2013; depreciation rates for additions after December 31, 2013; and net decommissioning cost amortization. AEPCO based the revised depreciation rates on an assessment of the gas and coal fired units at Apache Station conducted by Black & Veatch Corporation, which was filed with the application. The proposed depreciation rates are set forth in Exhibit B.

82. No party objected to the proposed new depreciation rates.

Conclusions

83. FVRB. AEPCO did not request a Reconstruction Cost New Rate Base, and thus its fair value rate base ("FVRB") is the same as its OCRB. The parties' proposed FVRB of $261,075,032 is supported by the evidence and should be adopted.

84. Test Year Revenues and Expenses. The undisputed adjusted test year revenues of $154,924,871 and test year operating expenses of $148,660,479 are supported by the evidence and should be adopted.

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[57] Tr. at 37. AEPCO anticipates that the EPA will issue its final rule incorporating AEPCO's BART alternative proposal by January 2014 (Tr. at 32), and estimates the estimated construction timeline at between 18 and 24 months (Tr. at 47-48).

[58] AEPCO Br. at 13-14.

[59] Trico Reply Br. at 3.

85. Revenue Requirement. Based on the entirety of the record, we find that AEPCO's proposed revenue level of $150,637,406 and net operating income (margin) of $1,957,221 will yield operating cash flow adequate to cover ongoing expenses, meet the Cooperative's principal and interest payments as they come due, and continue to build working capital to support future operating needs while considering the effect of rates on its member distribution cooperatives. AEPCO's proposed revenue level is just and reasonable and should be adopted.

86. COSS and Rate Design. The COSS and rate design based thereon are reasonable and supported by the evidence, and should be adopted.

87. PPFAC. AEPCO's request to continue its existing PPFAC with the modifications described herein is reasonable and should be approved, along with the efficacy provision we have included in prior rate cases.

88. Apache Station Study. We agree with the parties that the Apache Station Study as recommended by Staff, and clarified by the language presented at hearing, is needed. The testimony in this proceeding demonstrates that the exact means by which AEPCO will comply with environmental compliance obligations is unknown at this time. Similarly, it is currently unknown whether AEPCO will need to take action to address the issues Staff raised, and which AEPCO, Trico and Mohave disputed, concerning decreased competitiveness of Apache due to the availability of less expensive combined cycle gas generation. The results of the Apache Station Study as recommended by Staff, and clarified by the language presented at hearing, in conjunction with the forthcoming EPA ruling on the BART alternative proposal, will provide a framework for AEPCO to use in determining the course of action that will provide the best value for its customers. The parameters of the Apache Station Study as recommended by Staff and clarified by the language presented at hearing should therefore be approved, with the filing due no later than June 30, 2014.

89. ECAR. The concept of an ECAR as a cost recovery mechanism, when properly designed and used for projects that are the best long-term solution for AEPCO and its members, may be acceptable and reasonable. While a properly designed ECAR and plan of administration may provide a means for AEPCO to address future environmental compliance obligations, AEPCO has not presented a fully developed ECAR that we can approve in this proceeding. We note that AEPCO

suggested the ECAR in response to Staff's recommendation to reject AEPCO's proposed rate decrease.[60] Because we are not adopting Staff's revenue recommendation, AEPCO may not wish to file the ECAR in this case, and may determine instead to request any cost recovery in its next rate case, when the Apache Station Study has been completed, the EPA has ruled on AEPCO's BART alternative proposal, and AEPCO has developed its ECS. However, we will keep the record open in this rate case until April 30, 2014[61] for the purpose of allowing AEPCO to file, if it so chooses, after collaboration with Staff, an ECAR and plan of administration that fully addresses the technical points in regard to the ECAR raised by Staff as set forth in Findings of Fact No. 78 above.[62]

90. Notice of the ECAR. As Staff points out, increasing rates through an ECAR will not alleviate customer concerns with potentially rising rates. Due to the possibility of significant rate increases through an ECAR surcharge that would be passed on to the customers of the Class A member distribution cooperatives, if AEPCO files the ECAR in this rate case, we will require AEPCO to arrange to have notice of filing the ECAR provided to the customers of its member distribution cooperatives, in a form acceptable to its member cooperatives and Staff. Publication of the notice in newsletters published by its Class A member distribution cooperatives will be acceptable.

91. Expiring Purchase Power Contracts. Trico and AEPCO's request in regard to the expiring purchase power contracts is reasonable. We will therefore require AEPCO to file an application in this docket no later than August 1, 2014, requesting to remove from its rates all costs and charges related to the two purchase power contracts that expire on October 31, 2014, and this docket will be held open for that limited purpose.

92. Depreciation Rates. The proposed depreciation rates appearing in Exhibit B are reasonable and should be approved.

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[60] Rebuttal Testimony of AEPCO witness Gary E. Pierson, Exh. AEPCO-5 at 7-8.

[61] Keeping the record of this rate case open for a longer time period to allow the filing may present legal ratemaking issues. *See Scates v. Ariz. Corp. Comm'n,* 118 Ariz. 531, 578 P.2d 612 (Ariz. App. 1978).

[62] While the dollar amount of costs to be recovered need not be known for Commission approval of a surcharge mechanism or tariff rider, such a mechanism or rider must specifically delineate both the type (or types) of costs to be recovered, and the mechanism by which they will be recovered from ratepayers, and must be established in the context of a rate case.

CONCLUSIONS OF LAW

1. AEPCO is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-250 and 40-251.

2. The Commission has jurisdiction over AEPCO and the subject matter of the application.

3. Notice of the application was given in accordance with law.

4. AEPCO's FVRB is $261,075,032.

5. The rates and charges set forth in Exhibit A and authorized herein are just and reasonable.

6. It is just and reasonable and in the public interest to approve the depreciation rates set forth in Exhibit B.

7. It is just and reasonable and in the public interest to approve the continuation of AEPCO's PPFAC approved in Decision No. 72055 with the modifications discussed herein, along with a provision allowing AEPCO to make a filing requesting that the PPFAC be reviewed for efficacy.

8. It is just and reasonable and in the public interest to approve the parameters of the Apache Station Study as recommended by Staff and clarified by the language presented at hearing, and to require AEPCO to file it no later than June 30, 2014.

9. It is just and reasonable and in the public interest to hold the record open in this proceeding until April 30, 2014, for the limited purpose of allowing AEPCO to file a proposed ECAR and plan of administration for Commission approval.

10. Due to the possibility of significant future ECAR surcharges if AEPCO chooses to file an ECAR in this rate case, it is just and reasonable and in the public interest to require AEPCO to arrange to have notice of the ECAR which includes a description of the ECAR surcharge mechanism provided to the customers of its Class A member distribution cooperatives.

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11. It is just and reasonable and in the public interest to require AEPCO to file an application in this docket no later than August 1, 2014, requesting to remove from its rates all costs and charges related to two purchase power contracts that expire on October 31, 2014, and to hold the record open in this docket open for the limited purpose of addressing that application.

ORDER

IT IS THEREFORE ORDERED that the rates appearing in Exhibit A are hereby approved, effective for all service provided on and after November 1, 2013, and Arizona Electric Power Cooperative, Inc. is hereby authorized and directed to file with the Commission, on or before October 31, 2013, revised rate tariffs consistent therewith.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. shall notify its members of the revised schedules of rates and charges authorized herein within 30 days of the effective date of this Decision.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. is hereby authorized to continue the PPFAC authorized in Decision No. 72055, with the modifications set forth in the Ordering Paragraphs below, and the PPFAC Bases appearing in Exhibit A are hereby approved for all service provided on and after November 1, 2013. Arizona Electric Power Cooperative, Inc. is hereby authorized and directed to file with the Commission, on or before October 31, 2013, a revised PPFAC tariff and plan of administration consistent therewith, and consistent with the following four Ordering Paragraphs.

IT IS FURTHER ORDERED that the existing PPFAC tariff shall be modified to remove fixed fuel costs from the calculation of the PPFAC Base Resources and Other Resources Bases, and to instead track and recover those fixed costs through the establishment of a fixed fuel costs base and a separate adjustor rate based on a monthly charge.

IT IS FURTHER ORDERED that the PPFAC tariff shall be modified to remove the PPFAC bank balances from the fuel adjustor rates and recover those amounts, along with the fixed fuel costs bank balance, through a continuing six-month amortization tariff rider.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. is hereby authorized to implement a semi-annual PPFAC rider that is initially based on data covering the 12 months ended December 31, 2013, to be made on March 1, 2014, and to become effective on April 1, 2014. Thereafter, fuel adjustor filings shall become effective April 1 and October 1, based upon data covering historic performance during the prior 12 months ended December 31 and June 30, respectively.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. is hereby authorized to implement a temporary tariff rider that closes out the current PPFAC by refunding or collecting the outstanding Class A members' bank balances as of November 1, 2013, based on a 12-month amortization.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. may file, at the time it submits any semi-annual filing required by the PPFAC tariff and this Decision, a request that the Commission review the efficacy of the PPFAC.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. shall use the proposed depreciation rates appearing in Exhibit B on a going forward basis.

IT IS FURTHER ORDERED that the record in this case shall be held open until April 30, 2014, for the limited purpose of allowing Arizona Electric Power Cooperative, Inc. to file, if it so chooses, after collaboration with Staff, a proposed ECAR and plan of administration that fully addresses the technical points raised by Staff as set forth in Findings of Fact No. 78, for Commission approval.

IT IS FURTHER ORDERED that if Arizona Electric Power Cooperative, Inc. chooses to file the ECAR and plan of administration in this rate case, due to the possibility of significant rate increases through an ECAR surcharge that would be passed on to the customers of its Class A member distribution cooperatives, Arizona Electric Power Cooperative, Inc. shall arrange to have notice of filing the ECAR and plan of administration provided to the customers of its member distribution cooperatives. The notice shall include a description of the ECAR surcharge mechanism and its effects and shall be provided in a form acceptable to Staff. The notice may be accomplished by publication in newsletters published by its Class A member distribution cooperatives.

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IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. shall file with the Commission's Docket Control Center, as a compliance item in this matter, proof of the notice ordered in the previous Ordering Paragraph, within 30 days of the date upon which Arizona Electric Power Cooperative, Inc. files an ECAR and plan of administration for Commission approval.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. shall file, on or before June 30, 2014, with the Commission's Docket Control Center, as a compliance item in this matter, a non-confidential executive summary of the results of the SRPG study and supporting analyses. The filing shall include a notice indicating the date the results of the SRPG study and supporting analyses were provided to the Director of the Commission's Utilities Division.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. shall file, no later than August 1, 2014, with the Commission's Docket Control Center, as a compliance item in this matter, an application requesting to remove from its rates all costs and charges related to the two purchase power contracts that expire on October 31, 2014.

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IT IS FURTHER ORDERED that this docket shall remain open for the limited purposes of addressing the compliance application related to the two purchase power contracts and the ECAR filing.

IT IS FURTHER ORDERED that this Decision is effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN	COMMISSIONER

COMMISSIONER	COMMISSIONER	COMMISSIONER

IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 25th day of October 2013.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT ______________________

DISSENT ______________________
TJ:tv

SERVICE LIST FOR: ARIZONA ELECTRIC POWER COOPERATIVE, INC.

DOCKET NO.: E-01773A-12-0305

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EXHIBIT A

Collective All–Requirements Members

Fixed Charge - $/Month*	$ 280,682
O&M Charge - $/Month*	462,845
* The Fixed Charge and the O&M Charge will be apportioned among the CARMs based upon each CARM's monthly Demand Ratio Share.	
Energy Rates:	
Base Resources $/kWh	0.02958
Other Existing Resources $/kWh	0.03904
PPFAC Bases:	
PPFAC – Base Resources Base – Per kWh	0.02958
PPFAC – Other Resources Base – Per kWh	0.03904
PPFAC – Fixed Fuel Costs Base – Per Month	$ 183,236

Partial–Requirements Members

Mohave Electric Cooperative

Fixed Charge -$/Month	$ 856,617
O&M Charge - $/Month	1,433,723
Energy Rates:	
Base Resources $/kWh	0.02931
Other Existing Resources $/kWh	0.04118
PPFAC Bases:	
PPFAC – Base Resources Base – Per kWh	0.02931
PPFAC – Other Resources Base – Per kWh	0.04118
PPFAC – Fixed Fuel Costs Base – Per month	$ 549,433

Sulphur Springs Valley Electric Cooperative

Fixed Charge - $/Month	$ 758,513
O&M Charge - $/Month	1,269,525
Energy Rates:	
Base Resources $/kWh	0.02975
Other Existing Resources $/kWh	0.04139
PPFAC Bases:	
PPFAC – Base Resources Base – Per kWh	0.02975
PPFAC – Other Resources Base – Per kWh	0.04139
PPFAC – Fixed Fuel Costs Base – Per Month	$ 486,509

Trico Electric Cooperative

Fixed Charge - $/Month	$ 743,980
O&M Charge - $/Month	868,482
Energy Rates:	
Base Resources $/kWh	0.02984
Other Existing Resources $/kWh	0.03747
PPFAC Bases:	
PPFAC – Base Resources Base – Per kWh	0.02984
PPFAC – Other Resources Base – Per kWh	0.03747
PPFAC – Fixed Fuel Costs Base – Per Month	$ 574,197

EXHIBIT B

Arizona Electric Power Cooperative, Inc.

Schedule of Production Plant Depreciation Rates and Net Decommissioning Amortization
2012 Rate Case with Test Year 12 months ended 12/31/2011

1. Depreciation Rates

A. Rates for Production Units & Additions prior to 12/31/2013 (1)

	Proposed Rates	*Current Rates*
Unit ST1	**2.0025%**	*3.100%*
Unit ST2	**2.1298%**	*1.340%*
Unit ST3	**2.3278%**	*1.413%*
Unit IC1	**2.2385%**	*3.000%*
Unit IC2	**-0.1037%**	*3.000%*
Unit IC3	**2.0359%**	*3.000%*
Unit GT4	**3.1979%**	*3.000%*

Note: These Proposed Depreciation Rates remain unchanged through the end life of the Production Units, as defined by the Black & Veatch study

B. Rates for Production Units & Additions after 12/31/2013 (1)

Production Unit Additions in-service after 12/31/2013 will be depreciated over the Remaining Life of the applicable Production Unit by vintage year, the Depreciation Rate formula will be calculated as follows:

Step 1 - End Life Date of Production Unit minus Current Year = Remaining Life
Step 2 - 100% divided by Remaining Life = Depreciation Rate for that specific vintage year

(1) Subject to implementation date of new rates

2. Net Decommissioning Costs (as detailed in the Black & Veatch study)

	Net Decommissioning	Recovery Period	Proposed Annual Amortization
Unit ST1	40,100.00	22 years	**1,822.73**
Unit ST2	21,817,676.50	22 years	**991,712.57**
Unit ST3	21,819,576.50	22 years	**991,798.93**
Unit IC1	17,600.00	22 years	**800.00**
Unit IC2	(43,700.00)	22 years	**(1,986.36)**
Unit IC3	98,400.00	22 years	**4,472.73**
Unit GT4	(218,100.00)	22 years	**(9,913.64)**
	43,531,553.00		**1,978,706.95**

Net Decommissioning Costs as detailed in the Black & Veatch study equals the following:

a.) Decommissioning Costs	*61,027,200.00*
b). Salvage Value	*(14,382,200.00)*
c). Asset Retirement Obligation SFAS 143 Previously recovered by AEPCO	*(3,113,447.00)*
	43,531,553.00